No. 12588

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MARGARET BRYAN SMITH,

Appellant,

vs.

HARRY C. WESTOVER, United States Collector of Internal Revenue, Sixth Collection District of California,

Appellee.

BRIEF FOR APPELLANT.

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Opinion Below.

An opinion in this case was handed down by the District Court of the United States for the Southern District of California, Central Division, by Hall, J., which is set forth in the record on appeal. [R. 95-101.] Findings of Fact and Conclusion of Law were filed by the Court [R. 102-104], and Judgment was entered in favor of Appellee (defendant below). [R. 105-106.] The case is reported at 89 Fed. Supp. 432 (D. C. Calif., 1950).

Jurisdiction.

This appeal involves Federal income taxes, and is taken from a Decision and Judgment by the United States District Court, Southern District of California, Central Division, in favor of Appellee as United States Collector of Internal Revenue, Sixth Collection District of California. The taxes in dispute were paid to Appellee as follows [R. 9, 61]: $5,364.98 on April 12, 1944, $5,364.98 on June 1, 1944, $5,364.98 on September 13, 1944 and $6,929.15 on January 13, 1945, or a total payment on account of

Appellant's income tax for the year of 1944 in the amount of $23,024.09. Appellant in her individual income tax return for the taxable year of 1944 reported gross income in the sum of $45,086.99. Total tax liability reflected by federal return was $22,388.23 resulting in overpayment as thereby disclosed in the sum of $635.86. [R. 65.] Thereafter Appellee advised Appellant that computation of her alternative tax had reduced the total tax liability to $22,083.53 thereby increasing the overpayment disclosed by her return to $940.56, which overpayment was credited by Appellee to Appellant on her 1945 estimated tax. [R. 65.]

On May 6, 1946, Appellant filed a claim for refund in the amount of $14,510.27 with the Commissioner of Internal Revenue of the United States by filing her claim with Appellee as Collector, for said Commissioner in the manner provided by the laws of the United States in that connection. [R. 10, 61, 65.] Said claim for refund was rejected by the Commissioner of Internal Revenue and notice of such rejection was transmitted to Appellant on December 23, 1947. [R. 65.] Within the time provided in Section 3772 of the Internal Revenue Code and on March 18, 1948, Appellant brought an action in the District Court of the United States for the Southern District of California, Central Division, for the recovery of a portion of the Federal income tax paid by Appellant for the taxable year 1944. [R. 3-58, 76-95.] Judgment in favor of Appellee was entered April 18, 1950. [R. 105-106.] The Jurisdiction of this Court is invoked under Sections 1291 and 1294 of the Federal Judicial Code (28 U. S. C. A. 1291, 1294). Within one month and on May 15, 1950, Notice of Appeal was filed, together with designation and contents of Record on Appeal. [R. 107, 108.]

Questions Presented.

Whether, when under the provisions of a Testamentary Trust net income received and derived from the Trust estate is to be retained by the Trustee and as and when received immediately added to the principal or corpus of said Trust and thereafter considered as principal of said Trust, payments to a beneficiary of said Trust of 5 per cent of said principal or corpus are to be considered for Federal Income tax purposes as distribution of portions of said principal or corpus to said beneficiary.

United States Constitution, Amendment XVI.

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

Internal Revenue Code, Sec. 162(b)(c) and (d)(1) provide:

> "(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, 'income which is to be distributed currently' includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

"(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir or beneficiary;"

"(d) *Rules for Application of Subsections (b) and (c).*—For the purposes of subsections (b) and (c)—

"(1) *Amounts distributable out of income or corpus.*—In cases where the amount paid, credited, or to be distributed can be paid, credited, or distributed out of other than income, the amount paid, credited, or to be distributed (except under a gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals) during the taxable year of the estate or trust shall be considered as income of the estate or trust which is paid, credited, or to be distributed if the aggregate of such amounts so paid, credited, or to be distributed does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts so paid, credited, or to be distributed during the taxable year of the estate or trust in such cases exceeds the distributable income of the estate or trust for its taxable year, the amount so paid, credited, or to be distributed to any legatee, heir, or beneficiary shall be considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an

amount which bears the same ratio to the amount of such distributable income as the amount so paid, credited, or to be distributed to the legatee, heir, or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to legatees, heirs, and beneficiaries for the taxable year of the estate or trust. For the purposes of this paragraph 'distributable income' means either (A) the net income of the estate or trust computed with the deductions allowed under subsections (b) and (c) in cases to which this paragraph does not apply, or (B) the income of the estate or trust minus the deductions provided in subsections (b) and (c) in cases to which this paragraph does not apply, whichever is the greater. In computing such distributable income the deductions under subsections (b) and (c) shall be determined without the application of paragraph (2)."

Internal Revenue Code, Sec. 22(b)(3):

"(b) Exclusions From Gross Income.—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

"(3) Gifts, Bequests, Devises, and Inheritances.—The value of the property acquired by gift, bequest devise, or inheritance. There shall not be excluded from gross income under this paragraph, the income from such property, or, in case the gift, bequest, devise, or inheritance is of income from property, the amount of such income. For the purposes of this paragraph, if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;"

Statutes and Regulations Involved.

Treasury Regulation 111, Sec. 29.162-2 provides in part:

"Amounts distributable out of income or corpus—Sec. 162(d)(1).

"(a) *Allocation among annuitants.*—Section 162 (d) (1) applies to all cases in which the executor or trustee can or must (for example, by the terms of the trust instrument or will) pay the whole or any part of a gift, bequest, devise, or inheritance out of other than income, except that no income is to be allocated under it to a legatee, heir, or beneficiary of a lump sum gift, bequest, devise or inheritance. It applies in all cases of annuities where any deficiency in the amount to be paid can be made up by a payment out of corpus of the trust. It also applies in cases where amounts are to be paid or credited at intervals and the executor or trustee has discretion whether to pay or credit such amounts out of income or corpus, regardless of the source (income or corpus) to which the executor or trustee attributes such amount. If an annuity is paid, credited, or to be distributed tax-free, that is, under a provision whereby the executor or trustee will pay the income tax of the annuitant resulting from the receipt of the annuity, the payment of or for the tax by the executor or trustee will be income to the annuitant under the rules of section 162(d) to the extent such payment is treated thereunder as out of income.

"The method of allocating income of the estate or trust for its taxable year in cases to which section

162(d)(1) applies is as follows: The aggregate of all amounts which can be paid, credited, or distributed out of other than income (except under a gift, bequest, devise, or inheritance not to be paid, credited, or to be distributed at intervals) is obtained. The aggregate of such amounts is considered to be paid, credited, or distributed in such cases out of income of the estate or trust for its taxable year if it does not exceed the distributable income of the estate or trust for its taxable year. If the aggregate of such amounts does exceed the distributable income of the estate or trust for its taxable year, the portion of such amount paid, credited, or to be distributed to a legatee or beneficiary is considered income of the estate or trust for its taxable year which is paid, credited, or to be distributed in an amount which bears the same ratio to the amount of all distributable income as the amounts so paid, credited, or to be distributed to the legatee or beneficiary bears to the aggregate of such amounts so paid, credited, or to be distributed to such legatees or beneficiaries for the taxable year of the estate or trust. The proportion stated in the preceding sentence applies only to legatees or beneficiaries of amounts which can be paid, credited, or distributed out of other than income of the estate or trust and, in computing such proportion, the amount of any gift, bequest, devise, or inheritance not to be paid, credited, or distributed at intervals is not to be included."

California Civil Code, Sec. 2220. "A trust in relation to real and personal property, or either of them, may be created for any purpose or purposes for which a contract may be made."

California Civil Code, Sec. 1559: "A contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it."

California Civil Code, Sec. 863. "Except as hereinafter otherwise provided, every express trust in real property, valid as such in its creation, vests the whole estate in the trustees, subject only to the execution of the trust. The beneficiaries take no estate or interest in the property, but may enforce the performance of the trust."

California Probate Code, Sec. 163. "The provisions of this chapter are in all cases to be controlled by a testator's express intention."

California Probate Code, Sec. 161:

> "Legacies are distinguished and designated, according to their nature, as follows: . . .
>
> "(3) An annuity is a bequest of certain specified sums periodically; if the fund or property out of which a demonstrative legacy or an annuity is payable fails, in whole or in part, resort may be had to the general assets, as in case of a general legacy; . . ."

Statement of the Case.

The case was tried on the allegations in Appellant's complaint that were admitted, together with a stipulation of facts entered into by the parties. [R. 63-74.] It was further stipulated [R. 75] that the Order of the Superior Court of the State of California, in and for the County of Los Angeles, in Proceedings No. 179740, was the Order for Final Distribution of the estate of John B. Bryan distributing the estate (after certain specific distributions) to Margaret Bryan Smith and the Security-First National Bank of Los Angeles, a National Banking Association, as Trustees. Said Order defined the uses and purposes for which said trust estate was to be held in trust and set forth the terms of said trust. [R. 76-95.]

Said Decree of Distribution in referring to Article VII of the Last Will and Testament of the said John B. Bryan, deceased, provides as follows [R. 85-86]:

> "Article VII (of Will).
>
> "Definition of Net Income: From the gross income received and derived from the trust properties and/or from the principal thereof, if the Trustees deem that necessary, said Trustees shall first fully pay and discharge any and all taxes, assessments (both general and special), including governmental charges and costs, attorney's fees, expenses and liabilities incurred by them as such Trustees, or to which they may be entitled or which they may incur in connection with the care, administration, management, protection, preservation or distribution of said trust property, including a reasonable compensation to said Trustee for their services as Trustees hereunder. The remaining income shall be net income, withheld, accumulated or payable as follows:

"(a) The net income received and derived from the trust estate shall be by said Trustees, during the natural life of his daughter, Margaret Bryan Smith, retained by them and as and when received immediately added to the principal or corpus of said trust and thereafter such income and profits shall be considered as principal of said trust.

"(b) Said Trustees, beginning from the date of the distribution of the estate to them as Trustees, shall pay each year in convenient installments, monthly if possible, to his said daughter, Margaret Bryan Smith, during the term of her natural life, five per cent (5%) of the fair market value of the corpus of said trust. In determining the fair market value of the corpus of said trust and the percentage thereof herein directed to be paid to his said daughter, the said Trustees yearly on the anniversary date of his death shall cause to have the then trust corpus appraised by a banking institution or trust company in the County of Los Angeles, and for the year immediately following shall accept this said appraisal and pay to his said daughter five per cent (5%) thereof for each respective annual period. Upon the unanimous consent of the Trustees the Corporate Trustee may act as the Appraiser." [R. 85-86.]

John B. Bryan, died on September 18, 1938, a resident of the State of California, leaving a Will which was duly admitted to Probate on October 13, 1938, in Proceeding No. 179740, in the Superior Court of the State of California in and for the County of Los Angeles. Said Will contained among other provisions the Article VII quoted in part just above. On January 13, 1944, said Court sitting in Probate settled the Sixth and Final Account of the Executor's of said Will and made its Order and De-

cree directing a Final Distribution of the estate of the said John B. Bryan, deceased. [R. 63.] Net assets were by said Order distributed to Margaret Bryan Smith and the Security-First National Bank of Los Angeles, a National Banking Association as Trustees upon the trust set forth in said Last Will of John B. Bryan, deceased. The sum distributed amounted to $452,698.89. Appellant Margaret Bryan Smith is the beneficiary of said Trust as well as one of the trustees and is the daughter of John B. Bryan, the decedent. [R. 64.]

During the taxable year of 1944 the trust received net income after deductions in the sum of $24,348.14. [R. 64.] During the taxable year 1944 the trust commenced operations with the sum of $5,882.28 in cash, the accumulated income in the sum of $17,112.09 having been paid over to plaintiff. [R. 67.] Thereafter additional principal in the sum of $94.40 was distributed into the trust and the refund of federal estate tax principal was received in the sum of $5,305.52. [R. 67-69.]

A fiduciary income tax return was filed by the co-trustees of the John B. Bryan Trust with the Collector of Internal Revenue for the Sixth Collection District of California for the taxable year 1944 which reported a total income of the trust in the sum of $26,663.91. There was shown thereon deductions for trust expenses in the sum of $2,315.77 leaving a balance of $24,348.14. [R. 64.] The sum of $18,356.36 was distributed to Appellant during the year of 1944 and the Trustees claimed the payment of this amount as a deduction in computing net income of the trust taxable to the fiduciary. Appellant in her individual income tax for 1944 reported gross income in the sum of $45,086.99 including said sum of $18,356.36, paid to Appellant during the year 1944. [R. 64-65.] The tax lia-

bility claimed by the Collector amounted to $22,083.53, of which Appellant claimed that $14,510.27 represented an overpayment caused by the inclusion of the sum $18,-356.36 in Appellant's individual tax return for the taxable year 1944. A claim for refund was filed on May 6, 1946, for said sum of $14,510.27 which was rejected on December 23, 1947. Thereafter the action in the District Court followed which was commenced on March 18, 1948, by Appellant. It was stipulated Appellant is the owner and holder of said claim for refund. [R. 65-66.]

The Trust commenced operations with $5,882.28 of cash in its principal account from which payments were made from time to time and the principal account was finally replenished on July 13, 1944, when $10,000.00 was transferred from the income account to principal, prior to this there had been certain small payments to principal and one large principal receipt in the amount of $5,305.52 representing principal of a refund of federal estate tax.

The case was tried on the complaint insofar as the allegations were admitted with the exhibits attached thereto as amended together with a stipulation of facts including a financial account of the 1944 activities of the trust. It is not disputed and it appears clearly from the said account [R. 67-75], that it was the custom of the trustee in accordance wtih the directions of Article VII of the John B. Bryan Will to make the payments of 5 per cent of the corpus per annum, made on a monthly basis, out of accumulated principal cash on hand. When such principal cash had been virtually exhausted the trustee took a large portion of the accumulated income and added it to and comingled with corpus of the trust. As stated in the opinion and in the stipulation [R. 64] the trustees in accordance with the provisions of Article VII of the John B.

Bryan Will, annually valued the trust and made monthly payments therefrom equivalent to 5 per cent of the fair market value of said trust without reference to whether income had or had not been received.

Statement of Points to Be Urged.

1. The interpretation and application of Section 162(d)(1) of the Internal Revenue Code is unconstitutional in the instant situation for the reason that the constitutional power given by the Sixteenth Amendment applies only to income, and Appellant had no income from the trust.

2. The law of California, which governs the meaning and validity of the trust and the character and the validity of the interest of the beneficiary, is clear that the beneficiary has no interest in the corpus or income of the trust and has only a personal action against the trustee to compel performance of the trust provisions. Trust and beneficiary are each separate taxpayers. Interpretation of the intent of the trustor is governed by State law and the Commissioner of Internal Revenue is bound thereby. Such intent was clearly to apportion and pay out the corpus over a period of years, and such intent is controlling.

3. No income of the trust was distributed to Appellant but a portion of the trust corpus was set aside and distributed to Appellant. Once income from a trust is added to the corpus and comingled therewith such income although income to the trust when received thereupon ceases to be income and is thereafter an indistinguishable part of the trust corpus. Thus the trust should have paid the tax on the income it received for the year in which it was received. Appellant received distributions of 5 per cent of the corpus annually as a legatee and devisee and not as a recipient of income.

ARGUMENT.

Summary of Argument.

As the Commissioner of Internal Revenue attempts to apply Section 162(d)(1), such application is unconstitutional. The section itself if confined strictly to where payments are made of trust income to a beneficiary may be constitutional. Where such a section is applied constitutionally it provides a method of apportionment where a trust provides for the payment of sums out of income and provides for the invasion of corpus to insure full payment. No authorization of the Sixteenth Amendment is given for the particular tax here levied and to save the constitutionality of the statute it should be interpreted so as not to include payments made here to Appellant. The trust provides that income as received is to become part of the principal and this to be added to the principal on hand. No right whatever is given to Appellant to receive income and she is limited to the payment to her of five percent of the corpus annually.

The Commissioner of Internal Revenue was bound according to the laws, as set forth by the United States Supreme Court, to give effect to State law as it concerns the trustor's intent and the meaning, and the validity of the trust. The Commissioner is bound by the code of the State of California in dealing with the character and validity of the interest of the beneficiary in the trust. The beneficiary has no interest in the trust or its income and has merely the right to compel the trustee to follow the trust provisions to have the trustor apportion the corpus, and to pay out segments thereof over a period of years. This is controlling on the Commissioner.

It is clearly shown by the evidence that the trust added income to the corpus from time to time and accumulated such income, rather than paying it out to the beneficiary. The first payments were made from the principal cash on hand in excess of $10,000.00 and the balance of the payments were made from principal cash after it had previously been replenished and added to from trust income. Thus the Appellant received an indistinguishable part of trust corpus and the trustees should have paid tax on all of the income they received. The Appellant received distributions of five per cent of the corpus annually as a legatee, and devisee and not as a recipient of income.

POINT I.

The Section (I. R. C., Sec. 162(d)(1)) and the Regulations as Attempted to Be Applied Here Are Being Applied Unconstitutionally.

Conceding that the statute here involved may appear to be valid on its face, to have a reasonable relation to the ends sought to be subserved, and to run counter to no positive constitutional interdictions, nevertheless, if it is applied in a particular manner to a certain set of facts, such application may be unconstitutional. This was settled long ago, and the case of *Yick Wo v. Hopkins,* 118 U. S. 356 (1886), is a leading example of such a holding. This case concerned the denial by the municipal authorities of the City of San Francisco of equal protection of the laws to petitioner therein. Such authorities were engaged in an unfair and discriminatory administration of a city ordinance which was apparently valid on its face. Such unfairness and discrimination was held to be violative of the Fourteenth Amendment of the United States

Constitution as a denial of equal protection of the laws to the petitioner.

It is self-evident that the only constitutional authorities that the Commissioner of Internal Revenue can proceed under in levying this tax against Appellant, is from the power given to the Congress of the United States by the Sixteenth Amendment to the Constitution. Thus the Congress is given power to levy taxes on the recipient of income without limitation as to the source of that income. Nevertheless the derivation of income by an individual is an absolute condition precedent to the levy of the tax. If we proceed from the axiomatic proposition that Congress neither intended a capital levy nor an excise tax when it amended a portion of the Internal Revenue Code relating to income tax, it must be seen that it is incumbent upon the Commissioner in order to justify his levy to show that in some way the Appellant received income rather than a portion of corpus by inheritance.

The case of *Irwin v. Gavit,* 268 U. S. 161 (1925), established the rule, although there was strong dissent in the Court and elsewhere at the time, that income from a testamentary life estate is held taxable notwithstanding that an equivalent sum acquired outright by bequest, devise or inehritance is exempt from tax. The Court said at page 168:

> "But the distinction between the cases put of a gift from the corpus of the estate payable in installments, and the present, seems to us not hard to draw, assuming that the gift supposed would not be income.

> This is a gift from the income of a very large fund, as income. It seems to us immaterial that the same amounts might receive different color from their source. We are of the opinion that quarterly payments, which it was hoped would last for fifteen years, from the income of an estate intended for the plaintiff's child, must be regarded as income within the meaning of the Constitution and the law."

This distinction was enacted in the statute in the very first Income Tax Act (1913 Act, Sec. II, B), and is now expressed in I. R. C., Sec. 22(b)(3), which provides in part in defining gross income:

> "(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:
>
> . . .
>
> "(3) *Gifts, bequests, devises and inheritances.*—The value of the property acquired by gift, bequest, devise, or inheritance . . . if, under the terms of the gift, bequest, devise, or inheritance, payment, crediting, or distribution thereof is to be made at intervals, to the extent that it is paid or credited or to be distributed out of income from property, it shall be considered a gift, bequest, devise, or inheritance of income from property;"

It is therefore self-evident that the Congress has in the enactment of the Internal Revenue Code strictly followed the injunctions and authorizations of the Sixteenth Amendment to the United States Constitution, has been

very careful to tax only the receipts of income to the recipient, and has expressed itself in positive language to the effect that a receipt of property by gift, bequest, devise or inheritance is not taxable as income.

The distinction is pointed up even more saliently when it is noted that the same Internal Revenue Code contains numerous provisions dealing with estate and gift taxes and laying a tax upon the event of the receipt of a gift, or a receipt of a bequest, devise or an inheritance upon the distribution of an estate.

Following this case the cases of *Burnet v. Whitehouse,* 283 U. S. 148 (1930); *Helvering v. Pardee,* 290 U. S. 365 (1933); and *Helvering v. Butterworth,* 290 U. S. 365 (1933); established a clear rule of law concerning annual income and gifts of fixed sums certain for a period of years or for the life of the recipient. The distinction was thus made between a pure gift of income, which following the rule of *Irwin v. Gavit,* 268 U. S. 161, *supra,* was taxable to the recipient. The rule was further established, however, that in the event that it was decided that the trust provisions called for payments in all events, even though corpus might have to be invaded, then the whole of such payment was treated as if it were corpus and was not taxed as income to the recipient. The *Burnet v. Whitehouse* case, 283 U. S. 148 (1930), held that the recipient did not have to pay income tax on receipts of a payment certain and the correlative case of *Helvering v. Pardee,* 290 U. S. 365 (1933), stated that the trustee

could not deduct such payments made to a beneficiary even though from income. Payments purely from corpus were of course not taxable to the recipient. It is earnestly submitted by Appellant herein that the effect of the addition of I. R. C. Section 162(d)(1) was merely to change the rule with respect to the intermediate situation where corpus might or might not have to be invaded to make a periodic payment certain. Prior to the enactment of this statute even though corpus was never invaded nevertheless the receipt was not taxable to the recipient but the trust paid a tax on all of its income received without any deduction for payments to a beneficiary. No sound reason exists why in the instant case it should be construed that the burden of the income tax should be shifted from one tax paying entity, to-wit: the trust, to another, to-wit: the beneficiary. The Finance Committee was dealing strictly with these payments of income and in enacting the statute provided that if any particular payment contained a portion of corpus as well as income then the income tax should only be levied on the portion of such payment that actually represented income. (Senate Finance Committee Report No. 1631; Seventy-seventh Congress, Second Session, pp. 59-60.)

Clearly to avoid declaring Section 162(d)(1) of the Internal Revenue Code unconstitutional care must be taken by the courts to adopt that interpretation of the statutes which will avoid the raising of the constitutionality of it. (*Crowell v. Benson,* 285 U. S. 22, 62.)

POINT II.

The Law of the State of California Governs the Interpretation of This Trust and the Commissioner Must Take These Definitions as He Finds Them and Cannot Independently Determine Questions of State Law.

In effect Appellee here is contending that the Commissioner of Internal Revenue has the right to make an independent determination of the State law and to interpret the provisions of the trust so that certain portions thereof and certain payments thereof will be called income rather than corpus although the State law is very clear in defining the trust terms in a contrary manner. (*Blair v. Commissioner,* 300 U. S. 510; *Freuler v. Helvering,* 291 U. S. 35, 44.) The Court said, at pages 9 to 10, in *Blair v. Commissioner:*

> "The donor was a resident of Illinois and his disposition of the property in that State was subject to its law. By that law the character of the trust, the nature and extent of the interest of the beneficiary, and the power of the beneficiary to assign that interest in whole or in part, are to be determined."

A trust agreement in California in which the trustor conveys property to a third party who acts as trustee upon the promise of that party to convey such property to a third party in periodic installments is a valid trust in California and also is a contract for the benefit of a third party. In California contracts for the benefit of third

parties are valid and such transfer can be made in trust as well as absolutely. (California Civ. Code, Secs. 2220, 1559; *Estate of Reith,* 144 Cal. 314; *Pacific Ventura Corporation v. Huey,* 15 Cal. 2d 711, 718.) The trust and beneficiary are under the law of California separate entities (California Civ. Code, Sec. 863), and the action possible to a beneficiary is restricted to the enforcement by such beneficiary in appropriate equitable action of the duties of said trustee as defined by the laws of the State of California and by the trust instrument establishing the trust. (*Estate of Fair,* 132 Cal. 523; *Anglo-California Bank v. Kidd,* 58 Cal. App. 2d 651, 654.) The trust and the beneficiary are separate entities and are also recognized by Federal law to be separate taxpayers. (See *Anderson v. Wilson,* 289 U. S. 20, 27.)

It is also clear that the California law follows the Federal law and agrees with it in respect to the long standing difference between income beneficiaries and annuitants. Even if it can be conceded for argument that the status of annuitants whose whole annuity is paid out of income has been changed by the additions to I. R. C. Section 162, nevertheless we are concerned here with an apportionment of corpus and the payment by the trustee to the beneficiary of 5 per cent thereof annually.

POINT III.

Appellant Is Not the Recipient of Income nor Is She an Income Beneficiary, but Merely Received a Portion of the Corpus.

From the evidence itself it clearly appears that the Appellant was never by the provisions of the trust entitled to receive any income therefrom whatsoever. She was given the right to receive specified portions of the funds at stated intervals, which merely amounted to a postponement of the actual enjoyment of that portion of the corpus set aside for her. [R. 85-88.] The account of the trust [R. 67-74] shows that the Appellant first received one-twelfth of five per cent of the value of the corpus and the succeeding monthly payments of one-twelfth thereof from principal cash on hand in the trust. Thereafter, certain small payments were received. On April 18, 1944, a refund of $5,305.52 was received from the federal estate tax previously paid, which also became a part of the corpus. Payments continued to be made out of these funds until the income had accumulated and had been transferred to the principal which was done on July 13, 1944, in the amount of $10,000.00. This sum thereupon became an indistinguishable portion of the corpus and was completely comingled therewith. Therefore, it was as much a part of the principal cash as any other portion thereof and was indistinguishable from the rest of the corpus.

It must be presumed that the trustees followed the provisions of the trust in connection with the accumulation of income and transferred it to corpus. It is quite clear from the record [R. 67-74] that the trustees did actually follow the provisions of the trust insofar as possible here.

The trustees did not pay out income received by them but did in fact add such income to the trust corpus where it became an indistinguishable portion of the cash and securities comprising such corpus.

The only payments from the income were for trustees' fees except for the transfer of income into the corpus and two small payments of $6.90 and $9.13, respectively, for personal property tax and additional interest on federal income tax. [R. 70-72.]

Conclusions.

In conclusion it is submitted that the Court erred:

First: In holding that I. R. C. Section 162(d)(1) applies to Appellant and that such application was not unconstitutional.

Two: In not recognizing that the law of California governs and that the Commissioner is bound thereby and cannot treat that portion of the corpus as income to the Appellant.

Third: In refusing to recognize that the Appellant received corpus distribution, and not income distribution, and that the income of the trust had been indistinguishably conveyed to the corpus.

It is submitted that the decision of the Court below is erroneous and that said decision should have been that Appellant was entitled to a refund of the money claimed together with interest as provided by law.

Respectfully submitted,

John Moore Robinson,
Robert M. Himrod,
Counsel for Appellant.